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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

BEFORE THE
Federal Communications Commission
WASHINGTON, DC 20554

In the Matters of	)	
	)	
1998 Biennial Regulatory Review — Review of Accounting and Cost Allocation Requirements	)	CC Docket No. 98-81
	)	
United States Telephone Association Petition for Rulemaking	)	ASD File No. 98-64

REPLY COMMENTS OF U S WEST, INC.

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SUMMARY

The comments filed in this proceeding overwhelmingly support the proposed revisions to the Commission's accounting and cost allocation regulations proposed in the *Accounting NPRM*. The comments, however, do not justify the Commission's tentative decision to continue to apply the more stringent accounting and cost allocation rules to large incumbent LECs even though these carriers are now subject to no-sharing price cap regulation.

Indeed, comments filed by large incumbent LECs, such as U S WEST, demonstrate that the Commission did not go far enough to provide meaningful relief from costly, burdensome, and unnecessary accounting and cost allocation regulation to *all* LECs. The existing accounting and cost allocation rules impose unnecessary and costly constraints upon all incumbent LECs — large and mid-size. Moreover, less burdensome alternatives are available to protect against the potential for anticompetitive behavior. Simply put, the large LECs demonstrate that the existing accounting and cost allocation rules no longer serve the public interest and there is no rational basis for discriminating between large and mid-size LECs for purposes of applying more stringent requirements.

U S WEST concurs with the large incumbent LECs and urges the Commission to streamline its accounting and cost allocation rules for *all* LECs. The Commission should not only streamline existing rules and systems but also provide a blueprint for ultimately permitting the industry to adopt accounting systems to comply with GAAP without having to create additional records, work-around processes, and redundant data in order to meet both its ordinary business needs and the Commission's accounting requirements.

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REPLY COMMENTS OF U S WEST, INC.

U S WEST, Inc. ("U S WEST") hereby submits the following brief reply comments in the above-captioned proceeding.[1]

I. INTRODUCTION

The comments filed in this proceeding overwhelmingly support the proposed revisions to the Commission's accounting and cost allocation regulations proposed in the *Accounting NPRM*. Unsurprisingly, the primary beneficiaries of the *Accounting NPRM*, mid-sized local exchange carriers ("LECs") fully support the proposed revisions to the accounting and cost allocation rules.[2] As discussed below, however, these commenters do not justify the Commission's tentative decision to continue to apply the more stringent accounting and cost

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1 *See 1998 Biennial Regulatory Review — Review of Accounting and Cost Allocation Requirements; United States Telephone Association Petition for Rulemaking*, CC Docket No. 98-81, ASD File No. 98-64, *Notice of Proposed Rulemaking*, FCC 98-108 (rel. June 17, 1998) ("*Accounting NPRM*").

2 *See* Comments of ALLTEL Communications Services Corporation; Comments of Cincinnati Bell Telephone Company; Comments of Frontier Telephone of Rochester, Inc. ("Frontier"); Comments of Independent Telephone & Telecommunications Alliance ("ITTA"); and Comments of Sprint Local Telephone Companies ("Sprint").

allocation rules to large incumbent LECs even though these carriers are now subject to no-sharing price cap regulation.[3]

The majority of the remaining commenters, large incumbent LECs such as U S WEST, support the *Accounting NPRM* in general, but argue that the Commission did not go far enough to provide meaningful relief from costly, burdensome, and unnecessary accounting and cost allocation regulation to *all* LECs.[4] As these commenters demonstrate, the existing accounting and cost allocation rules impose unnecessary and costly constraints upon all incumbent LECs — large and mid-size.[5] These commenters also point out numerous, less burdensome alternatives that are available to protect against the potential for anticompetitive behavior. Yet the *Accounting NPRM* failed to explore any such alternatives. Instead, the *Accounting NPRM* does nothing to relieve entities that comprise nearly 90% of the local exchange telecommunications industry from the existing accounting and cost allocation rules — contrary to the mandate of Section 11 of the Communications Act to eliminate rules that no longer serve the public interest.

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3 COMSAT Mobile Communications ("COMSAT") supported the proposal and urged the Commission to clarify that the streamlined accounting and cost allocation regulations proposed for mid-sized carriers would also apply to COMSAT. *See* COMSAT Comments.

4 Lexcom Telephone Company ("Lexcom"), a small incumbent LEC, filed comments asking the Commission to adopt a new, and even less detailed, Class C system of accounts for small incumbent LECs. *See* Lexcom Comments at 8-11.

5 Comments of U S WEST at 8-10; *see also* Comments of Ameritech at 4-10; Comments of Bell Atlantic at 2-6; Comments of BellSouth at 5-9; Comments of GTE Service Corporation at 3-13; Comments of Southwestern Bell Telephone Company, Pacific Bell and Nevada Bell ("SBC Comments") at 5-24; Comments of United States Telephone Association ("USTA") at 6-11.

The large incumbent LECs, therefore, uniformly urge the Commission to streamline its accounting and cost allocation rules for *all* LECs. The Commission should not only streamline existing rules and systems but also provide a blueprint for ultimately permitting the industry to adopt accounting systems to comply with generally accepted accounting principles ("GAAP") without having to create additional records, work-around processes, and redundant data in order to meet both its ordinary business needs and the Commission's accounting requirements.[6] Recognizing that the elimination of the existing rules may not be accomplished immediately, these carriers offered the Commission recommendations for streamlining the existing rules on an interim basis.[7]

U S WEST submits that the record before the Commission supports the position advocated by the large incumbent LECs. As discussed below, the comments demonstrate that the existing accounting and cost allocation rules no longer serve the public interest. Further, there is no rational basis for discriminating between large and mid-size LECs for purposes of applying more stringent requirements. Therefore, U S WEST urges the Commission to streamline existing rules and systems and also to set forth a blueprint for eliminating the existing rules in favor of state-of-the-art accounting, recordkeeping, and cost allocation practices which are generally used by publicly-traded companies.

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6 *See, e.g.,* GTE Comments at 19; Bell Atlantic Comments at 7-10.

7 *See generally,* Ameritech Comments; Bell Atlantic Comments; BellSouth Comments; GTE Comments; SBC Comments; USTA Comments.

II. EXISTING DETAILED ACCOUNTING AND COST ALLOCATION RULES NO LONGER SERVE THE PUBLIC INTEREST

Of the sixteen parties that filed comments, only MCI Telecommunications Corporation ("MCI") opposed the *Accounting NPRM*. In MCI's view, the public interest benefits of maintaining the current accounting and cost allocation rules outweigh the cost of continued application of the rules.[8] MCI asserts that Class A accounting provides the Commission with essential tools to ensure that interstate ratepayers do not subsidize competitive activities on the part of incumbent LECs.[9] MCI insists further that reliance on Class B accounting will limit the Commission's ability to conduct tariff investigations and monitor the development of local competition.[10] Finally, MCI asserts that the *Accounting NPRM* overstates the cost burden associated with Class A accounting.[11]

MCI's arguments are unsupportable and simply represent its position of opposing any regulatory relief for LECs regardless of the merits. All other commenters reject MCI's position and argue that revisions to the existing rules are necessary and would serve the public interest. Indeed, the Commission implicitly recognizes this fact by proposing to relieve mid-size carriers of Class A obligations pursuant to the Section 11 mandate to eliminate regulations that are no longer in the public interest.

Moreover, the Arthur Andersen Report submitted in this proceeding demonstrates that the Commission's existing accounting and cost allocation rules do not reflect the regulatory

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8 MCI Comments at 5.

9 *Id.* at 5-6.

10 *Id.* at 3-5.

11 *Id.* at 5.

and competitive realities of today's markets.[12] Today, U S WEST, and the other large incumbent LECs, are subject to no-sharing price cap regulation rather than the rate-of-return regulation contemplated by the existing accounting and cost allocation rules.[13] Under price cap regulation, a carrier's rates are no longer based upon its cost-of-service plus a return on capital investment. Thus, any misallocation of costs between regulated and non-regulated activities will have no impact on rates and, by extension, strict rules for allocating costs do not serve to protect consumers. Consequently, the detailed plant asset balances and accounting records are no longer relevant for Commission regulatory purposes. In effect, then, the existing rules have become nothing more than regulation for regulation's sake without any significant benefit to the public interest.[14]

U S WEST recognizes that Class A accounting detail has been used in past tariff investigations and other federal and state regulatory activities.[15] This fact, however, does not mean that continued application of Class A accounting is warranted. As numerous commenters to this proceeding point out, Class B accounting provides the Commission sufficient detail to undertake its continuing regulatory obligations. Further, as the Arthur Andersen Report shows, permitting *all* carriers to comply with GAAP without additional regulatory requirements will

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12 *See* Arthur Andersen LLP, "Accounting Simplification in the Telecommunications Industry," (filed July 15, 1998) ("Arthur Andersen Report"). The report was prepared on behalf of a coalition of large incumbent LECs consisting of Ameritech Corporation, BellSouth Corporation, GTE Service Corporation, SBC Communications Inc. and U S WEST.

13 *See* Arthur Andersen Report at 10-11.

14 *See, e.g.,* Ameritech Comments at 6-8; BellSouth Comments at 4; SBC Comments at 20-24.

15 MCI Comments at 3-4.

enable the Commission to undertake meaningful comparisons or "benchmarking" both between the various sectors of the telecommunications industry and with entities outside the industry.[16] Such benchmarking can enable the Commission to meet efficiently its regulatory obligations. Moreover, as Ameritech points out, to the extent that detailed accounting data is necessary for any particular investigation, the data will be available from the underlying accounting records.[17] Thus, the data can be obtained, on an as-needed basis, even if a given LEC uses Class B accounting.

Finally, MCI's statement that the costs of Class A accounting are understated is simply wrong. Several commenters in this proceeding demonstrate the significant costs associated with complying with the existing accounting and cost allocation rules. For example, GTE states that it spends $1 million annually to conduct the required Part 64 cost allocation manual ("CAM") audit.[18] Bell Atlantic states that it spends more than $8 million a year to maintain its continuing property records and that ongoing compliance with Part 64 requirements costs over $9 million a year.[19] In short, incumbent LECs are saddled with extremely high costs associated with the existing accounting and cost allocation rules.

In light of the above, U S WEST submits that it is almost beyond question that the existing accounting and cost allocation rules no longer serve the public interest and should be

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16 Arthur Andersen Report at 12.

17 Ameritech Comments at 11.

18 GTE Comments at 15.

19 Bell Atlantic Comments at 5 n.3, 9.

revised. Moreover, as discussed below, the rules should be revised for *all* LECS, not for a single class of carriers arbitrarily defined by annual revenue figures.

III. THERE IS NO RATIONAL JUSTIFICATION FOR DISPARATE TREATMENT OF "LARGE" AND "MID-SIZE" LECs

As noted above, the primary beneficiaries of the *Accounting NPRM*, mid-size LECs, fully support the proposed revisions to the accounting and cost allocation rules, including retaining Class A accounting and cost allocation requirements for large incumbent LECs. No commenter, however, provided any adequate justification for applying more stringent accounting and cost allocation rules to incumbent LECs with annual operating revenues of $7 billion or more. At best, commenters reiterated the Commission's position that large LECs offer a large volume of competitive products and services, thereby creating opportunities to subsidize competitive services and the countervailing need for close regulatory scrutiny.[20] Sprint goes on to note that the Commission will continue to receive Class A accounting data from LECs representing 90% of the local exchange industry, "thus ensuring that [Commission] oversight of the industry as a whole will remain intact."[21] This rationale is without merit — the volume of competitive services offered by large LECs is relatively small and there is no significant need for Class A accounting and cost allocation details to protect against anticompetitive conduct.

The comments in this proceeding demonstrate that large LECs do not provide a large volume of competitive services, even when compared with mid-size LECs.[22] Indeed,

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[20] *See, e.g.,* Sprint Comments at 2; Frontier Comments at 1-2.

[21] Sprint Comments at 2.

[22] *See, e.g.,* U S WEST Comments at 9; USTA Comments at 7-9; Ameritech Comments at 4-5.

ITTA, a supporter of the *Accounting NPRM*, argues that mid-size LECs do not engage in "'lower volumes' of competitive traffic."[23] Thus, the justification for the disparate treatment of large and mid-size LECs offered by the Commission and reiterated by commenters is wrong as a matter of fact.

Further, as demonstrated by the comments of the large LECs, the reliance on size, as measured by revenue, to distinguish between LECs for purposes of accounting and cost allocation requirements is arbitrary and unwarranted.[24] The Commission suggests that large LECs have a greater opportunity to subsidize competitive services and therefore must be monitored more closely.[25] The Commission also suggests that Class A accounting and cost allocation is required to support its obligations under Sections 254(k), 260, and 271-276 of the Communications Act.[26]

The fact is, however, there is no nexus between the $7 billion threshold for Class A requirements and the Commission's obligations to protect consumers against cross subsidization and to comply with the provisions of the Communications Act. The statutory provisions cited by the Commission are all aimed at preventing cross-subsidization of certain activities. The large LECs, however, are now subject to no-sharing price cap regulation at the federal level and in most states. No-sharing price cap regulation essentially eliminates the incentive and opportu-

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23 ITTA Comments at 3-4.

24 *See, e.g.,* U S WEST Comments at 9-10; BellSouth Comments at 9-11; SBC Comments at 7-8.

25 *Accounting NPRM* at ¶¶ 6, 12.

26 *Id.*

nity for LECs (whether large or mid-size) to cross-subsidize services.[27] Insofar as there is no incentive or opportunity to cross-subsidize services, Class A accounting and cost allocation is not necessary for the Commission to protect consumers or to comply with its obligations under Sections 254(k), 260, and 271-276 of the Communications Act.

Further, the Commission's obligations under Section 272, 273, and 274 of the Act relate solely to the regulation of separate affiliates of a Bell Operating Company ("BOC"), not the regulation of the BOC itself. These separate affiliates are not subject to Part 32 accounting requirements at issue in this proceeding. Further, it is unclear how the Class A accounting and cost allocation details regarding the activities of the BOC are necessary or even relevant to the Commission's regulation of the separate affiliate. In addition, by severing the link between cost and price, no-sharing price cap regulation eliminates the incentives for large LECs to subsidize their unregulated affiliates and vice versa. In sum, there is simply no basis for the Commission to distinguish between large and mid-size LECs for purposes of imposing Class A accounting requirements. Consequently, the Commission should streamline its accounting and cost allocation rules to provide *all* LECs the flexibility necessary to prosper in today's competitive environment.

IV. THE COMMISSION SHOULD REVISE RAO LETTER 26

As a final point, U S WEST supports commenters who urge the Commission to revise Responsible Accounting Officer ("RAO") Letter 26,[28] except U S WEST believes that RAO Letter 26 should be rescinded as to *all* LECs. As these commenters note, while RAO

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27 *See, e.g.,* Bell Atlantic Comments at 4-6; BellSouth at 10; GTE Comments at 5-6.

28 *See* Cincinnati Bell Comments at 7-8; Sprint Comments at 6.

Letter 26 purports to streamline the CAM requirements by 40%, the Letter imposes new detailed reporting requirements which more than offset any streamlining. Under RAO Letter 26, U S WEST will be required to track and report virtually all of the same information, plus several additional details. Indeed, the 1991 RAO Letter 19 instructions for the entire CAM were 1.5 pages, but now RAO Letter 26, which addresses requirements in CAM Section 5, is 11 pages.

The imposition of such additional regulatory burdens runs counter to the express purpose of the *Accounting NPRM*, indeed of Section 11 itself. Further, companies have already petitioned the Commission to reconsider RAO Letter 26.[29] Therefore, U S WEST urges the Commission to take this opportunity to revise RAO Letter 26 to eliminate the requirements that LECs provide redundant and unnecessary information. Specifically, the Commission should eliminate: (a) mandated frequency codes; (b) required descriptions of the nature of each affiliate's business; (c) required statements of precisely which valuation method applies to each affiliate transaction; and (d) the additional reporting requirements for asset transfers.

These requirements are rigid, inflexible, overly detailed, and impose new and onerous accounting obligations upon U S WEST and all incumbent LECs. U S WEST is unaware of any significant regulatory benefit to be derived from these reporting requirements. Consequently, U S WEST urges the Commission to take this opportunity to revise or rescind RAO Letter 26.

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[29] On June 4 and 5, 1998, BellSouth and SBC respectively sought Commission review of RAO Letter 26.

CONCLUSION

For the reasons set forth above, and in the comments filed in this proceeding, U S WEST urges the Commission to revise its accounting and cost allocation rules to provide *all* carriers the flexibility necessary to prosper in today's competitive environment. Such revisions should not only streamline existing rules and systems but also should guide the industry toward accounting, recordkeeping, and cost allocation practices which are generally used by publicly-traded companies. Finally, the Commission should rescind or revise RAO Letter 26 consistent with the discussion above.

Respectfully submitted,

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Date: September 4, 1998

CERTIFICATE OF SERVICE

I, Jo-Ann G. Monroe, hereby certify that I have on this 4th day of September, 1998 caused a copy of the foregoing Reply Comments of U S WEST, Inc. to be served by First Class, U.S. mail, postage prepaid, on the following:

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